Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for	)	
Local Exchange Carriers	)	WC Docket No. 07-135
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing an Unified Intercarrier	)	
Compensation Regime	)	CC Docket No. 01-92
	)	

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Separate files (noted where redacted under Protective Order) include:

Exhibit A – Impact of Proposals on HCL Support – 16 pages

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Exhibit C – Impact of removal of corporate operations expense from LSS (**redacted copy included in public filing**) – 2 pages

EXECUTIVE SUMMARY

Addressing the issues posed in the Notice is ripe for resolution. We concur with the Commission's stated intent at paragraph 12 of the Notice to avoid sudden changes or implement flash cuts in its USF and ICC policies. If careful deliberation is not undertaken, the end result will eventually lead to a degradation of service if rural carriers are unable to recover the cost of maintaining their networks. As carriers of last resort, networks are constructed. The concept of lines being added incrementally is a myth.

The short term proposals offered by the Commission are a mixture of changes to existing rules for intercarrier compensation that attempt to address access arbitrage with potentially drastic changes to current USF rules that could significantly impact the support payments that rural wireline carriers receive.

GVNW prepared a price out of the Commission's NPRM proposal to adjust the support percentages contained in the High Cost Loop fund algorithm. The proposed change in the rules appears to be a change in policy from directing money to the highest cost to serve customers to customers that are a lower cost to serve in companies that just cross the threshold of being eligible for support.

We respectfully disagree with the Commission's view regarding corporate expense as stated in paragraph 197 that: *"the Commission agreed with commenters that these expenses do not appear to result from cost inherent in providing telecommunication service, but rather may result from managerial priorities and discretionary spending…"*

While we believe there is some discretionary spending involved, we think it quite unlikely that a company could provide telecommunications services under current regulation without incurring costs associated with accounting, management, insurance, legal, and regulatory compliance.

The methodology described in the proposal attempts to isolates the corporate operations expense as it is excluded from the ICLS computation, but there is no specific proposal with regards to how this isolated cost will be recovered. Is it the intent of the Commission to require that SLC rates be increased to recover this difference? Is it the Commission's intent to shift this explicit subsidy back to the original source as an implicit subsidy through per minute carrier common line charges assessed to the interexchange carrier? Is the Commission planning to introduce a new recovery mechanism for this cost? To isolate this cost and allow no opportunity for recovery would undoubtedly result in confiscation claims.

The Commission must be cautious to recognize the interdependence that wireless carriers have on wireline networks. The mobility provider depends on the wireline provider in its call completion architecture. Current wireless, VoIP, and satellite networks require a connection to land line infrastructure to provide full functionality.

A significant portion of a rural wireline carrier's network cost recovery has been based on intercarrier compensation (ICC). A foundational cornerstone of any reform strategy must include the ability for rural wireline carriers to recover the investments already deployed while maintaining a comparable rate structure as required in Section 254 of the Telecommunications Act of 1996.

If the Commission, in partnership with state regulators, were to proceed with any such reductions in intrastate access charges, there must also be created a mechanism that will afford rural wireline carriers the opportunity to replace the lost revenue from the rate equalization. Without this type of revenue offset, rural carriers would be unable to continue the transition to a more ubiquitous broadband network in the highest cost to serve areas of the country, and customers of these carriers face the potential for very significant increases to local rates or SLCs that would not meet the comparable rate standard found in Section 254.

We offer four key criteria to evaluate the path to long-term reform:

1) Does the plan comply with federal law?

2) Does the plan incent the transition to broadband without damaging one set of rural customers in favor of other rural customers?

3) Does the plan provide for the recognition that voice is not yet merely an application, and COLR obligations are still relevant?

4) Does the plan result in comparable rates for rural customers compared to urban customers without excessive SLC increases?

The proposal in the instant Notice suggests that a mandatory disaggregation plan is now appropriate. While most consultants and attorneys might well welcome the positive incremental impact on firm revenue from conducting a complex study for each and every client they presently serve, we question the efficacy of the Commission proposal for several reasons.

The results are striking – the price cap carriers have had the resources to deploy infrastructure investment to their rural operating territory. Simply stated, the price cap companies made a choice not to invest in less populated areas in order to improve their operating results. It would be prudent for the Commission to very carefully approach the rural-rural divide issue and not issue blank checks to large national carriers that have a well-established track record of not deploying rural investment.

Introduction and Background

In the instant Notice of Proposed Rulemaking (NPRM), the Commission seeks comment on short-term and long-term reforms to USF and ICC.

GVNW Consulting, Inc. (GVNW) is a management consulting firm that provides a wide variety of consulting services, including regulatory and advocacy support on issues such as universal service, intercarrier compensation reform, and strategic planning for communications carriers in rural America. We are pleased to have the opportunity to offer comments addressing the issues the Commission has raised in this important Notice.

Addressing the issues posed in the Notice is ripe for resolution. We concur with the Commission's stated intent at paragraph 12 of the Notice to avoid sudden changes or implement flash cuts in its USF and ICC policies. If careful deliberation is not undertaken, the end result will eventually lead to a degradation of service if rural carriers are unable to recover the cost of maintaining their networks.

We concur with the statements offered on April 5 by Senator Rockefeller at the hearing conducted by the Senate Commerce, Science, and Transportation Committee: "*Access to modern communications is not a luxury. It's a right. All people, no matter who they are or where they live, deserve access to …broadband. Without access to these services, too many of our citizens will be left on the wrong side of the digital divide and denied the job opportunities, educational development, health care options and personal safety that modern communications networks provide."*

Some of the proposals offered by the Commission in this Notice threaten to destroy decades of progress to providing this access in rural America. Our comments are focused to these concerns.

NEAR-TERM REFORMS DISCUSSED IN SECTION XV ARE RIPE FOR IMPLEMENTATION

The short term proposals offered by the Commission are a mixture of changes to existing rules for intercarrier compensation that attempt to address access arbitrage with potentially drastic changes to current USF rules that could significantly impact the support payments that rural wireline carriers receive.

As we noted in our Section XV comments filed on April 1, the FCC has proposed "phantom traffic" rules by amending 64.1601. We recommended these rules be adopted as an initial step toward addressing this issue. We also recommended that the proposed rules be enhanced by adding additional language[1].

We certainly understand the Commission's desire to aggressively address the traffic pumping situation. We also encourage the Commission to craft rules and carefully set triggers that will permit the recognition of the difference between artificially inflated demand levels from traffic level changes that are the result of rural economic development activity that changes prior traffic patterns.

The FCC should take actions in 2011 to confirm that current access charges apply to all traffic terminating via carrier facilities on the public switched telecommunications network (PSTN). There should be no exceptions based on regulatory classification or the technology used to originate the calls (e.g., VoIP). We recommend that there be an immediate obligation for VoIP traffic to pay existing ICC rates, in order to put an end to the arbitrage activity related to this type of traffic.

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[1] We recommend that the proposed rules be enhanced by adding the following sentence to the end of proposed 64.1601 (a) (1): *Entities subject to this provision shall transmit Carrier Identification Codes (CIC) or Operating Company Number (OCN) codes in addition to the Calling Party Number (CPN).*

NEAR-TERM REFORM ISSUES ON USF AND ICC

We have calculated the impact of the Commission proposals on current USF mechanisms in Exhibits A – C (redacted data shown in Exhibits B and C).

Price-Out of NPRM proposal to Change Support Levels for High Cost Loop Fund

GVNW prepared a price out of the Commission's NPRM proposal to adjust the support percentages contained in the High Cost Loop fund algorithm: For the level of support for cost between 115% and 150% of the national average, the adjustment was from 65% to 55%; and for the level for cost over 150% of the national average, the adjustment was from 75% to 65%.

The data used for the price out was publicly available information which was filed by NECA with the Commission on September 30, 2010. The imputed National Average Cost per Loop (NACPL) for rural companies was adjusted from the $458.36 which was included with the September filing to $422.06 to maintain the capped level using the lower recovery percentages.

The proposed change in the rules appears to be a change in policy from directing money to the highest cost to serve customers to customers that are a lower cost to serve in companies that just cross the threshold of being eligible for support. For example, the current mechanism limits the amount of loop cost that is assigned to the state jurisdiction to 89.75% of the NACPL used to calculate the capped HCL fund. Under the current approach, no company would have more than $411.38 per loop assigned to the state jurisdiction to cover the loop cost, or $34.28 per line per month. Under the proposed revision, there is no limit to the amount that can be assigned to the state jurisdiction.

Based on the calculations, a high cost company like Beaver Creek (D/B/A Timberline Telecom) in the state of Washington will be required to shift $99.11 per line per month that it would have received from the Interstate HCL fund to the state jurisdiction. This equates to $1,189.32 per line on an annual basis that the company will have to recover through intrastate revenue. It is unclear what adjustments the Washington Utilities and Transportation Commission (WUTC) can make to accommodate this transfer in cost from the interstate jurisdiction to their jurisdiction.

The opposite side of this reshuffling of the HCL fund is a company like United of Eastern Kansas that would have received a total of $58,476 from the HCL fund and would receive $1,007,627 from the fund with the proposed formulae. Another example is Illinois Consolidated who would have received $245,923 under the current formulae, but would receive $1,420,428 with the proposed formulae.

<u>Quantitative Data indicates that the FCC should not eliminate Corporate Expenses from HCL, LSS and ICLS</u>

In this section, we address some of the issues associated with the NPRM proposal regarding the elimination of corporate expense from HCL, LSS and ICLS. There is a significant difference in the purpose and operation of these three mechanisms and the proposal leaves some questions unresolved.

Before we discuss the specific proposal, we respectfully disagree with the Commission's view regarding corporate expense as stated in paragraph 197 that:

> *"the Commission agreed with commenters that these expenses do not appear to result from cost inherent in providing telecommunication service, but rather may result from managerial priorities and discretionary spending…"*

While we believe there is some discretionary spending involved, we think it quite unlikely that a company could provide telecommunications services under current regulation without incurring costs associated with accounting, management, insurance, legal, and regulatory compliance.

We hope the Commission has not made this proposal to eliminate corporate expense from the support mechanisms as a result of a misguided belief that all corporate expenses are discretionary. We recommend the Commission seriously evaluate how long a regulated telecommunication provider could continue to provide telecommunications services if it abandoned all activities that result in charges to the corporate expense. We also ask the Commission to review the proceedings that developed the current allowable level of corporate expense as the Commission in prior rulings clearly recognized that some level of corporate expense[2] was required to provide the services.

Basic corporate operations functions that must occur in a going concern include salaries of general manager and support staff; board of directors costs; financial and regulatory accounting functions; annual audit requirements; cost separations studies; maintaining relations with government and regulators, including preparing and presenting information to FCC and state PUC, including CALEA and CPNI compliance; national and state association dues that create efficiencies for small carriers; information management tasks and necessary legal costs.

[2] See, for example, GVNW ex parte letter dated July 8, 1997 to Mr. Kenneth P. Moran, FCC, CC Docket No. 96-45.

Overview of Support Mechanisms

HCL – The high cost loop mechanism was designed to provide support to the state jurisdiction in order to keep local rates at an affordable level. This is accomplished by shifting expenses from the state jurisdiction to the interstate jurisdiction.

LSS – The local switching support mechanism was designed to cover a portion of the interstate switching cost in order to keep the per minute switching rate at a lower level and to shift the support from an implicit support through higher per minute rates for switched access to an explicit support in order to keep the per minute rates at a more affordable level.

ICLS – The interstate common line support mechanism was designed to shift recovery of a portion of the interstate common line requirement from implicit support using Carrier Common Line (CCL) charges to an explicit support fund. The computation was developed to assure the rate of return LECs would have **an opportunity** to receive their 11.25% rate of return on investment assigned to the interstate common line element.

Evaluation of HCL Proposal

The mechanics of the HCL support uses data from a prior period to develop the amount of support needed, and then the "Subpart D" expenses are adjusted to shift expense from the state jurisdiction to the interstate jurisdiction. It is this expense adjustment that provides the support needed to keep local costs down, thus allowing local rates to be maintained at an affordable level. Since the expense adjustment is assigned to the interstate jurisdiction in the Part 36 and Part 69 rules, the funding coming from the HCL fund is used to cover this interstate expense.

Since the Part 36 rules do not specify how much of the Subpart D expenses associated with each account are adjusted, we suspect that the study quoting the 13% of Corporate Expense in the HCL for 2011 does not reflect the expenses from subpart D that will be assigned to interstate in 2011 but rather is going from the data from a prior period used to calculate the amount of the total expenses being shifted.

The focus on the proposed rules is directed at the computation of the support amount. It should be noted that under the proposal, there will be no reduction of the HCL fund. Instead, it will result in a redistribution of the capped fund, creating winners and losers. The losers will shift cost from interstate back to the state jurisdiction and the winners will shift more cost from the state to the interstate compared to current rules. This proposed change brings into question if the program continues to provide sufficient support to allow for reasonable rates that are comparable to other areas.

To illustrate the impact of this change, we will provide some company specific numbers for the Range (Wyoming) study area (Study area code 512251). The last completed cost study is 2009, so we will use the 2009 study period for these computations. The HCL for 2009 was based on 2007 data that was submitted in July of 2008. For purposes of this example, we will use the same NACPL (national average cost per loop) for the computation with and without the corporate expense. For purposes of developing the initial HCL support for 2009, Range was allowed to use $2,363,242 of 2007 corporate expense in the computation. The amount of support initially developed was $3,048,129. If all of the corporate expense is dropped out of the computation, the resulting HCL support would drop by $752,403 to $2,295,726. With the 16,260 subscriber loops for 2009, the exclusion of corporate expense from the computation results in a shift of expense from the interstate to the state jurisdiction of $46.27 per subscriber loop.

Evaluation of LSS Proposal

Unlike the HCL, the Local Switching Support is computed in Part 54.301 using study period data rather than a prior period's data. The amount calculated is then used to reduce the Part 69 Local Switching revenue requirement to remove the explicit support from the switching rates. Removing the corporate operations expense from the LSS computation will result in more revenue requirement being recovered from switching rates and from common line. This change seems counter to the direction the Commission has expressed with regards to lowering or eliminating switched access rates.

With regards to the Range (Wyoming) study area; there was $3,083,075 of corporate expense includable in the final true-up calculation of support for the 2009 study period. The LSS amount for 2009 was $1,013,662. If the corporate expense were removed, the LSS[3] would drop to $800,484 leaving an additional $213,178 that would need to be recovered through a combination of switching rates and from common line. (Note that 30% of this would need to be recovered through common line rates as a result of the MAG adjustment – Part 69.306(d) (2)). The company records indicate Range - Wyoming had 53,144,829 interstate minutes of use for 2009. The additional rate that

[3] The proposal to combine the current LSS mechanism with the current HCL mechanism is problematic as there is not a one-to-one correlation among mechanism recipients. The recent industry trends have shown that the LSS is trending downward, which could justify holding any changes in abeyance and reexamining LSS reform in conjunction with future ICC reform. If this path were selected, we would expect that the aggregate LSS levels would continue to trend downward due to continued reductions in switched access cost levels.

would need to be charged to recover the portion of this $213,178 remaining in local switching (i.e. $149,225) is $0.0028 per minute.

Evaluation of ICLS Proposal

Currently, the interstate common line recovery is accomplished through two major components, the end user common line (EUCL or SLC) charges and the ICLS. There are several other mechanisms that contribute a very small amount to the recovery of the common line revenue requirement, so we mention them here and then exclude them through the rest of the discussion as being immaterial. The other sources as identified in Part 54.901(a) are as follows:

- The carrier common line charge revenues to be phased out pursuant to part 69.105.
- The special access surcharge pursuant to Part 69.114
- The line port costs in excess of basic analog service pursuant to Part 69.130
- Long Term Support

ICLS under the current rules is a mechanism whereby the revenue requirement that is not recovered through the subscriber line charges is recovered through the ICLS. The current rules also establish a maximum rate for SLC charges at $6.50 for residential service and $9.20 for multi-line business service.

The methodology described in the proposal attempts to isolates the corporate operations as it is excluded from the ICLS computation, but there is no specific proposal with regards to how this isolated cost will be recovered. Is it the intent of the Commission to require that SLC rates be increased to recover this difference? Is it the Commission's intent to shift this explicit subsidy back to the original source as an implicit subsidy through per minute carrier common line charges assessed to the interexchange carrier? Is the Commission planning to introduce a new recovery mechanism for this cost? To isolate this cost and allow no opportunity for recovery would undoubtedly result in confiscation[4] claims.

The proposal also does not address how much, if any, corporate expense is associated with the line port costs being shifted from the switching revenue requirement to the common line revenue requirement. Is the assumption that any corporate expense included in the line port adjustment has lost its identity and should therefore be ignored with regards to the corporate exclusion for the ICLS computation? Should a portion of the line port adjustment be "tagged" as corporate expense? If so, how is the amount to be calculated?

The proposal also does not address how much, if any, corporate expense is associated with the transport interconnect charge (TIC) that is allocated to the common line element as prescribed in Part 69.415. The reallocation is performed at the revenue requirement level and therefore, there is no specific identification of individual expense components associated with the adjustment.

For Range Wyoming, we will ignore any corporate expense associated with the $161,530 line port shift to common line and the $380,798 TIC reallocation to common line. The amount of direct corporate expense assigned to common line in 2009 is $572,123. If the Commission's intent were to increase SLC charges to recover this expense, an additional $35.19 per subscriber would need to be collected each year. If it

[4] We also believe that if the Commission decides to impose limitations on the recovery of existing investment, such an approach would be unreasonable as it would apply retroactive ratemaking that companies could not have anticipated prior to committing company funds and incurring obligations with lenders. We respectfully recommend that the Commission take a more forward-focused approach in order to avoid the lengthy and contentious confiscation cases that would certainly result from such an Order.

were the Commission's intent to recover this through reinstituting the carrier common line charge, there would be a charge of $0.0108 per minute.

REVERSE AUCTIONS ARE NOT THE ANSWER FOR THE RURAL CARRIER PORTION OF THE REFORM EQUATION

The Commission has requested comments on the reverse auction proposals as a part of the initial implementation of the CAF. Since the Commission has been considering reverse auction proposals for over a decade, previous Commissioner Statements are reflective of the problems inherent with a transition to a reverse auction proposal. Commissioner Copps highlights some of the key unanswered questions in the following excerpt:

"...our review raised in my mind many more questions than it answered. For instance, how do we ensure that the winning bidder provides adequate quality of service? What happens if the winner later decides it is no longer profitable to continue its operation? And who will be responsible for establishing the rules and enforcing them? Ironically, this purportedly market-based approach strikes me as hyper-regulatory. For these reasons, I must dissent from the NPRM's tentative conclusion that the Commission should develop an auction mechanism to determine high-cost support."

Other prior statements include Commissioner McDowell offering something that is relevant to this proceeding. In his statement accompanying the Notice of Inquiry in WC Docket No. 07-52 (FCC 07-31), the Commissioner states in part: "*But we also must resist the temptation to impose regulations that are based merely on theory*." This is particularly important with respect to any proposed reverse auction approach.

Former Commissioner Adelstein's statement offered the following observation:

" To that end, I am also concerned about the impact of reverse auctions and whether such mechanisms can provide adequate incentives for build out in Rural America. For these reasons, I dissent from the tentative conclusions in the separate Reverse Auctions Notice. . . .I cannot support these premature tentative conclusions, and would have

preferred a more balanced presentation of the potential disadvantages of such an approach."

The purpose in this section of this comment filing is to assist in providing a more balanced presentation of the potential disadvantages of such an approach for the record, if eventually applied to rural carriers.

<u>The Provider of Last Resort concept is not consistent with a reverse auction experiment</u>

Providers of last resort must be able to deploy infrastructure to provide service to all customers, even those who live in high cost to serve areas. For rural carriers, reverse auctions would have the end result of decoupling rural carriers from the cost-based rate-of-return model. The implications of such an approach could be to jeopardize the viability of these rural carriers and frustrate the attainment of universal service in areas where there are few providers capable of fulfilling provider of last resort responsibilities. This would appear to be quite contrary to the working model of a provider of last resort.

<u>The Commission would have controlled fund growth if not for the identical support rule</u>

In one sense, reverse auctions appears to be a proposal to ameliorate problems resulting from the largest error made in implementing the Telecommunications Act of 1996 (TA 96): the identical support rule. It would also appear from the data currently in the record that reverse auctions do not constitute the competition that was envisioned in TA 96. One may argue that such competitive bidding is actually anti-competitive per TA 96, at least with respect to a customer's access to competitive alternatives. In the proposed reverse auction approaches, carriers are only on an equal basis once every bidding cycle. If an existing rural wireline carrier were to be unsuccessful in a reverse auction proceeding, it is unclear as to how the Commission would intend to address confiscation issues.[5]

Reverse Auctions raise significant public policy issues for high cost to serve areas and should not be implemented initially in these areas

Implementing a reverse auction approach for rural carriers could have unintended consequences, including a continued challenge in obtaining debt financing or the inability to raise capital[6] and evolve appropriate levels[7] of service.

The ability to evolve service capabilities is seriously compromised as the auction winner may have no incentive to spend beyond the proscribed service level. This seems contradictory to the administration's goals and Congressional support present for a continuing evolution to broadband networks.

When the Commission considered the reverse auction concept a decade ago, there was no public consensus on how to structure competitive bidding to make it reduce the overall amount of support.[8] At that time, the decision was made to not pursue reverse auctions. If the current Commission chooses to "reverse" this prior decision, we respectfully submit that carriers other than rural wireline carriers should be the subject of such an experiment. Given the uncertainty regarding such an approach, and the lack of

[5] Even with an adequate transition, it is not clear that the Commission may supersede intrastate depreciation rates in light of the *Louisiana* standard.
[6] Comments of CoBank, WCD No. 05-337, April 17, 2008, page 4: "*…If a telecommunications provider is faced with the possibility of losing access to universal service support funding through a reverse auction system, lenders will restrict the amount of debt available. This lack of access to capital could impair the ability of service providers of all types to meet the growing telecommunications needs of rural Americans."*
[7] Comments of the OPASTCO, WCD No. 05-337 and CCD No. 96-45, October 10, 2006, page 12: "*Reverse auctions do not naturally encourage network upgrades and service quality improvements*."
[8] Recommended Decision, CC Docket No. 96-45 (Federal-State Joint Board on Universal Service), November 6, 1996, paragraph 334.

empirical data[9] as to what constitutes a successful auction scenario, we believe rural carriers are not the proper subset on which to experiment in this regard.

Rural carriers often are the only provider of ubiquitous and high-quality service[10] in a service area.

<u>Reverse auctions would create an uncertainty with respect to capital recovery and retard the deployment of rural infrastructure</u>

Rural carrier telecommunications networks necessitate investing large amounts of capital in inherently long-lived plant assets. These investments are possible when lenders have a reasonable certainty of debt repayment[11] and investors/stockholders/cooperative members are afforded an opportunity to receive a compensatory rate-of-return.

Under the proposed reverse auction scenario, universal service support would not be predictable over the long term. After the contract period expires, support for an area would be re-auctioned. In the subsequent period, the initial bidder, who will have made long-term investments to serve a rural area, would only retain its revenues if it submitted the winning second bid. This type of uncertainty would certainly not provide sufficient incentive for efficient, long-term investment strategies that are prerequisite to infrastructure[12] deployment in low density, high cost to serve areas of the country.

[9] "*The Use of Reverse Auctions for Provision of Universal Service*" Professor Dale E. Lehman, Attachment to comments of the National Telephone Cooperative Association, WCD No. 05-337 and CCD No. 96-45, October 10, 2006, stating in part: "*while the track record of reverse auctions utilized in new service areas is of limited relevance to the U.S., theoretical evidence of reverse auctions in areas with existing infrastructure has not been studied, and scant empirical evidence of their usefulness exists*."

[10] Rural carriers are measured against the 99.999% standard of reliability, not the "fewest number of dropped calls" as cellular carriers claim in their network and cable television advertisements.

[11] Conversely, lenders available to rural carriers will be unwilling to provide new capital if there is significant uncertainty regarding the ability to meet principal and interest obligations.

[12] See, for example, NASUCA ex parte of March 30, 2011: "*Specifically with regard to the Connect America Fund, we oppose the use [of] reverse auctions…*"

Without adequate network performance standards firmly in place, the Commission will have fired the starting gun for a race to the bottom in terms of service quality

The enforcement of service quality standards could be a difficult task for the Commission. In a competitively bid contract scenario, the purchasing party has the obligation to enforce the terms of the contract upon the bidder. At the same time, the financial incentives for the winning bidder are to perform the work at a lower cost than was bid. In order to prevent this natural incentive to cut costs resulting in a degradation of service, some form of oversight by a regulatory authority would be required.

Reverse auctions would create no incentive to invest after the contract, and would be especially acute in the later years of a contract cycle. For example, carriers would be unable to justify investing in long-lived assets in the eighth or ninth year of a ten year contract period when faced with the possible loss of support in year eleven.

Other important policy questions that the Commission must consider include: How does the Commission propose to monitor the winner's performance and how does the Commission intend to handle the provision of service when carriers exit high cost to serve markets if they are not the successful auction bidder?

In this regard, the Commission must be cautious to recognize the interdependence that wireless carriers have on wireline networks. The mobility provider depends on the wireline provider in its call completion architecture. Current wireless, VoIP, and satellite networks require a connection to land line infrastructure to provide full functionality. This network reality is documented in *Wireless Needs Wires: The Vital Role of Rural Networks in Completing the Call*, published by the Foundation for Rural Service in March, 2006. This paper states in part:

> *Without thoughtful consideration by policymakers of the challenges of providing wireless services in rural America, as well as the dependence of wireless services on wireline networks, portions of the nation are likely to remain underserved . . .Most importantly, one must recognize that without the underlying wireline network, wireless networks could not exist in their current form. In spite of this obvious fact, large wireless carriers and policymakers alike continue to pursue practices and policies that will in fact undermine the critical wireline network. While discussions on how to modify reciprocal compensation, access charges, and universal service continue, attention must be placed on ensuring these mechanisms are capable of maintaining the fiscal health of that wireline network.*

A question that must also be answered is what are the “costs” from a public policy perspective for reverse auction winners that are ultimately unable to perform universal service functionalities? Historically, the “provider of last resort” (POLR) designation has provided a reasonable assurance that customers in remote regions of the country will have access to communications services. An important part of the POLR package has been the availability of universal service support. The reverse auction proposals do not appear to address an adequate fallback[13] position for customers in rural areas where the “winner” is unable to meet its commitment. This leads to another public policy question that must be answered: How would the Commission propose to mitigate a large carrier from low balling a bid to win the auction, and then ignore the low-density portion of the area? While this may not be important to 90+% of the customers, it is of vital importance to the potentially disenfranchised 10%. We encourage the inclusion of a rural incumbent carrier exemption in any approach to reverse auctions.

[13] Prior discussion concerning awarding a single winner seemingly conflicts with the recognition that wireline and wireless services are complementary, and not substitutable.

ISSUES FOR REFORMING INTERCARRIER COMPENSATION

A significant portion of a rural wireline carrier's network cost recovery has been based on intercarrier compensation (ICC). A foundational cornerstone of any reform strategy must include the ability for rural wireline carriers to recover the investments already deployed while maintaining a comparable rate structure as required in Section 254 of the Telecommunications Act of 1996.

A logical first step is to unify interstate and intrastate rates per carrier

ICC reform has been debated at the Commission for well over a decade. On almost an annual basis, there have been recommendations to equalize intrastate access rates with the generally lower interstate access rate levels. As noted in the NPRM at paragraph 552: "…*There is general industry sentiment that intrastate rates should be reduced first because they are the highest, and because eliminating the discrepancy between intrastate and interstate access charges could reduce arbitrage, such as phantom traffic.*"

If the Commission, in partnership with state regulators, were to proceed with any such reductions in intrastate access charges, there must also be created a mechanism that will afford rural wireline carriers the opportunity to replace the lost revenue from the rate equalization. Without this type of revenue offset, rural carriers would be unable to continue the transition to a more ubiquitous broadband network in the highest cost to serve areas of the country, and customers of these carriers face the potential for very significant increases to local rates or SLCs that would not meet the comparable rate standard found in Section 254.

The Commission requests comment at the above-referenced paragraph 255 as to whether there is an appropriate federal role in such an offset mechanism. We respectfully submit that in order to meet its responsibility under Section 254 to provide for comparable rates between rural and urban areas, there is indeed an important public policy role[14] for the Commission.

Mandatory Bill and Keep is not the appropriate target

Beginning at paragraph 529, the Commission poses questions as to the appropriate target for comprehensive ICC reform, including a bill-and-keep methodology as one of the choices. We believe that a mandatory bill-and-keep approach would be detrimental to rural wireline carriers and the customers that they serve. If rural carriers were not permitted to charge other carriers that use their network, it is unlikely that the rates to end-user customers will continue to meet the comparability standard. One possible outcome of large increases to rates for voice and broadband services would be to retard broadband penetration levels to the rural areas of the country. This does not comport with achieving a NATIONAL broadband plan. The Commission itself recognizes this fact as stated at paragraph 80 of the NPRM, where it states in part:

[14] The Commission fulfilled this type of role when it undertook the challenges that culminated in both the 2001 MAG Order [*Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers*, CC Docket No. 00-256, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77, *Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers,* CC Docket No. 98-166, Second Report and Order and Further Notice of Proposed Rulemaking, Fifteenth Report and Order, and Report and Order, 16 FCC Rcd 19613, 19651, 2001] for small carriers and the CALLS Order for larger price cap carriers. It is also appropriate public policy at this juncture to establish a benchmark rate metric that includes the local rate, federal and any state SLCs, and mandatory EAS charges to ensure that arbitrarily low local rate levels are addressed in this reform effort. We currently understand that the RLEC plan will endorse a benchmark starting at $25 that includes the rate components above, and we tentatively support that as an appropriate starting point.

Third, the program must ensure that rates for broadband service are reasonably comparable in all regions of the nation, and rates for voice service are reasonably comparable in all regions of the nation. Availability of broadband and voice service by itself is not a sufficient goal. We must also make sure that rates are reasonably comparable so that consumers have meaningful access[15] *to these services.*

For customers to continue to have comparable and affordable rates in rural areas, the Commission must proceed with great care as it crafts long-term ICC reform. We recognize that as the network transforms to an entirely IP-based platform, usage based access pricing will no longer be viable. However, there are other methods, such as charging users on a capacity-type basis for access that merit serious consideration if the Commission is committed to continuing its long-held approach of providing for an equitable approach for rural carriers.

LONG-TERM REFORM ISSUES

The Commission had been seeking "the answer" to USF and intercarrier compensation reform for the last 15 years. We anticipate seeing at least two proposals with respect to dealing with embedded investment cost recovery, and since we have not had a chance to perform adequate price out analysis, will reserve our comments until the reply round slated to be submitted on May 23, 2011. The challenge now facing the Commission also includes the need to determine the best long-term path to reform USF.

The Commission will see a wide variety of proposals in response to this Notice. We encourage the Commission to consider the RLEC proposal that will be offered in this

[15] Meaningful access for consumers is different than providing free access to carriers to a network that has a real cost to maintain. The Commission refers frequently to "sending the proper pricing signals." We respectfully suggest that a compensation rate of zero may send improper pricing signals to IXC carriers, wireless carriers and VOIP providers that will lead to increased capacity demands to rural wireline carriers who would then have an inadequate opportunity to recover the economic costs of expanding the network capacity.

comment round. As we understand the discussions to this point, the RLEC proposal shifts the focus of future support mechanisms to broadband via an approach that starts with an adjusted amount of today's interstate allocated network costs, and then adds support calculations for the critical "middle mile" facilities and necessary access to the Internet backbone. Carriers would be eligible to receive support for broadband transmission costs after subtracting a benchmark cost amount. It is also our understanding that RLEC CAF support amounts would increase as broadband adoption increases. While it is premature to fully evaluate a plan that has yet to be filed, we are optimistic that the filed RLEC plan will create the proper incentives and path for long-term reform.

<u>There are four key criteria to consider for long-term reform</u>

As a preface to our analysis in the reply round, we offer some public policy criteria for use in evaluating the NPRM proposals, the RLEC plan, and other submissions to the record in this docket:

1) Does the plan comply with federal law?

2) Does the plan incent the transition to broadband without damaging one set of rural customers in favor of other rural customers?

3) Does the plan provide for the recognition that voice is not yet merely an application, and COLR obligations are still relevant?

4) Does the plan result in comparable rates for rural customers compared to urban customers without excessive SLC increases?

We offer preliminary thoughts on each of the four criteria.

Compliance with federal law

Section 254 of the Telecommunications Act of 1996 requires that federal universal support be specific, predictable and sufficient. Many of the short-term proposals offered by the Commission do not provide predictable and specific federal universal support that is sufficient to meet the federal law requirement of universal service. Absent Congressional action changing the law, the FCC must adopt rules that meet all legal requirements.

As noted in the comments of the Utah Public Service Commission and Utah Division of Public Utilities filed on April 14 in this docket:

The PSC and the Division believe that a longer, better-conceived transition is needed if the Commission is to achieve its broadband goals without undoing past successes. Any transition period should continue to provide some level of support for investments made in reliance on the availability of federal support. The PSC and the Division urge the Commission to reject the proposed changes.

Incent the transition without damaging rural wireline customers

We recognize that the Commission faces a significant challenge with respect to the lack of broadband availability in significant portions of area served by price cap regulated large carriers. We urge the Commission to proceed with great care in this endeavor, as the solution to the complex issue often referred to as the "rural/rural digital divide" is not to penalize rural wireline customers in favor of others. As we note later in the accountability section, price cap carriers have made choices not to deploy infrastructure in some of their high cost areas, as evidenced by the interstate rate of return they have realized as reflected in the last available ARMIS data for 2007. We have provided this data in this filing as Appendix 1 starting at page 35.

Voice must be viable during the transition, and COLR obligations are still relevant

While we are in a transition to a paradigm where voice service will evolve to being an application on the broadband suite of services, we are not there yet. Accordingly, the functions that must be performed by rural wireline carriers as carriers of last resort cannot be ignored or cast aside. One of the most important ramifications of this fact is that rural carriers construct networks; they do not build lines one by one. Thus, any short-term modifications to federal universal service support must continue to provide sufficient and predicable support while carriers of last resort obligations are enforced.

The obligations that rural wireline carriers fulfill extend to public safety and national security. Put simply, not all border crossings are served by large national carriers. For example, Triangle Communications, Inc. is one of Montana's rural wireline carriers and provides service at three international border crossings. Meeting requests from the federal government for expanded services and high-speed access are only possible if Triangle continues to receive sufficient and predictable federal universal service support.

Comparable rates means no excessive increases to local rates or SLCs

As demonstrated in the data included with this filing, certain of the Commission's proposals could have the effect of creating the need for excessive increases to local rates or SLC levels. We have been engaged in discussions with Commission staff to modify the Commission's data request found at footnote 853, in order to better facilitate rural carrier responses. We are hopeful that the revised format will provide a larger sample of respondents, with data that further demonstrates the problematic nature of FCC proposals related to short-term reform.

MANDATORY DISAGGREGATION IS NOT THE ANSWER

A decade ago, the Commission implemented an option for carriers to compute a geographic disaggregation of federal universal service support on a study area basis. This option was intended to permit eligible carriers to assign support relative to cost to serve, in an attempt to ensure that CETCs would receive a lower level of per-line support if they chose to serve in only the lower-cost portion of a study area, under the ill-advised identical support rules.

The proposal in the instant Notice suggests that a mandatory disaggregation plan is now appropriate. While most consultants and attorneys might well welcome the positive incremental impact on firm revenue from conducting a complex study for each and every client they presently serve, we question the efficacy of the Commission proposal for the following reasons:

1) With the Commission proposal to eliminate the identical support rule over the next several years, what need does mandatory disaggregation fulfill?

2) The cost to conduct a disaggregation study is properly categorized in Part 32 as a corporate operations expense. With the draconian proposals in the Notice to limit rural carrier recovery of corporate operations expenses, how does the Commission support the concept of increasing this category of expense?

3) The same lack of clear purpose appears to extend to the concept of states redrawing study area boundaries, as referenced at paragraph 384 of the Notice. prior to a clear definition and scope related to the end game CAF being established. This would appear to be a clear case of “putting the cart before the horse.”

PER-LINE CAPS IGNORE UNIQUE CIRCUMSTANCES FOR SERVING ISOLATED AND PREVIOUSLY DISENFRANCHISED CUSTOMERS

In the Notice, the Commission offers a proposal that would impose a $3,000 per-line cap on annual support for non-tribal companies located in the contiguous "Lower 48" states. By our calculations, the end result of this type of action could be to penalize over 10,000 customers that happen to live in extremely remote and rural service territories.

While the press reports on this aspect of USF sensationalize the issue, we respectfully offer some of the rest of the story. One company included in this small subset, Beaver Creek – Washington d/b/a Timberline Telecom is serving a remote area that had never been served. The Washington Utilities and Transportation Commission actively recruited a carrier to meet the needs of a small group of very isolated customers as a carrier of last resort, or perhaps more appropriately a carrier of only resort. Timberline has made substantial investments to meet the needs of these rural and isolated customers under the understanding that they were in compliance with the tenets of Section 254 of the Telecommunications Act of 1996.

PAST PERFORMANCE IS RELEVANT IN THE ACCOUNTABILITY DEBATE

Non-regulated net income for rural carriers will not "offset" proposed reductions to support mechanisms

There has been some opinion expressed by Commission staff during this reform debate that rural carriers should be able to rely on their nonregulated revenues (we believe net income is the proper metric) to offset reductions in federal universal service payments. A number of our client companies have contacted us, expressing a belief that the provision of individual company data will be important in the advocacy of rational legal and policy arguments that refute opinions similar to the one referenced above.

Under separate ex parte, we will be providing data prior to the end of April from a statistically valid sample of our client companies that demonstrates that there is not adequate nonregulated income to offset any level of support reductions. As you would expect, this data will be filed under the protective order option in this docket.

Will the large carrier propensity to avoid rural investment ever change?

One of the lead torch-carriers for the "rural-rural digital divide" debate has been Windstream. In their recent April 5 ex parte, Windstream alleges that *"reform is essential to eliminate the rural-rural "digital divide" that has arisen under current federal program rules ...while other high-cost areas – exhibiting comparable cost conditions – are virtually ignored."*

The phrase "virtually ignored" caught our eye, as we reflected on the data we compiled from the last available ARMIS data (2007) filed at the Commission for large price cap carriers. Our interpretation of the data is that large price cap carriers have virtually ignored an obligation to invest in their most rural service areas.

We are aware that these large companies have tried to discount the significance of the absolute level of the calculated interstate rates of return due to factors including, but not limited to: time period for the data; use of frozen categorization in their underlying data; and relevance of rate of return to a price cap entity. With respect to the direct relevance of a rate of return computation to a price-cap regulated entity, we recognize that this is not an area that merits[16] an extended discussion. But, the numerator and denominator in the rate of return calculation may provide an insightful analysis.

With regard to the numerator, the data is relevant with respect to an analysis of whether adequate revenues were available to invest in infrastructure. With 61 of the 79 study areas showing an interstate rate of return for that period exceeding 25%, we would respectfully suggest that there have been adequate revenue sources to extend investment to more rural areas. An explanation for these very high levels of earned rate of return[17] for price cap companies is found in footnote 375 in this Notice [FCC 11-13].

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[16] In the Notice, Paragraph 598 offers: "*An incentive regulation system can better encourage efficient operation, because carriers that can substantially increase their productivity can earn and retain profits at reasonable levels above those [allowed] for rate of return carriers*." We observe that the results reflected in Appendix 1 may be higher than the Commission had anticipated.

[17] Part of the explanation for these high rates of return may come from the information found in footnote 375 in this FCC Notice [FCC11-13]: *See id.*, 15 FCC Rcd at 13028-29, paras. 160-63. Because price cap carriers reached their target rates at different times, the inflation-only X-factor took effect at different times for different price cap carriers. In the *CALLS Remand Order*, the Commission concluded that price cap carriers serving 36 percent of total nationwide price cap access lines had achieved their target rates by their 2000 annual access filing. *CALLS Remand Order*, 18 FCC Rcd at 15002, para. 43, 15010-13, App. B. By the 2001 annual access[ing] filings the number grew to carriers serving 75 percent of total access lines, and by the 2002 annual access filings, carriers serving 96 percent of total access lines had achieved their target rates. *Id.* As a result, price cap carriers serving nearly all price cap access lines have had no reductions to their price cap indices, productivity-related or otherwise, since 2002, and some price cap carriers have had no reductions in ten years.

The denominator of net investment may shed some light as to what the investment patterns are for the subject carrier. Analysis of some of the net investment data in the denominator shows that such investment has not been made. An examination of some of the rural western states proves this point. Qwest earned interstate rates of return (e.g., Oregon 45.92%, Washington 53.93%, Montana 59.74%, Wyoming 73.65%, Colorado 55.27%, Utah 53.03%, New Mexico 78.32%, Nebraska 68.42%, North Dakota 56.75%) is driven largely by lower than needed average net investment (rate base) in the rate of return calculation.

Does it make sense, from a prudent public policy perspective, to shift from an opportunity to earn 11.25% and meet customer infrastructure needs to a system in which companies routinely earn over 30% by choosing not to serve rural territory? We respectfully suggest that that would not be a better system for customers in high-cost to serve areas of rural America.

The results are striking – the price cap carriers have had the resources to deploy infrastructure investment to their rural operating territory. Simply stated, the price cap companies made a choice not to invest[18] in less populated areas in order to improve their operating results.

It would be prudent for the Commission to very carefully approach the rural-rural divide issue and not issue blank checks to large national carriers that have a well-established track record of not deploying rural investment.

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[18] We respectfully submit that the earned rates of return reflected in Appendix 1 are generated by the reason offered in the last sentence at paragraph 598 in this Notice [FCC 11-13]: "***On the other hand, concerns sometimes are expressed that forms of incentive regulation can lead carriers to reduce costs by reducing investment***." (Footnote omitted).

Respectfully submitted,

Via ECFS at 4/18/11

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Appendix 1 – Calculation of Interstate Rate of Return for Large Carriers based on 2007 ARMIS data

Company	Y2007
Contel California	87.23%
Southwestern - Oklahoma	86.90%
Southwestern - Arkansas	84.49%
Qwest-New Mexico	78.32%
Contel Arizona	74.05%
Qwest-Wyoming	73.65%
Verizon NO-Contel/Indiana	71.32%
Verizon NW-Idaho	70.70%
Verizon SO-Virginia	70.54%
Qwest-Nebraska	68.42%
Pacific Bell - California	63.64%
Qwest-Idaho South	63.22%
Qwest-Montana	59.74%
Southwestern - Kansas	59.43%
Qwest-Iowa	59.07%
Qwest-North Dakota	56.75%
Qwest-Colorado	55.27%
Verizon SO-Contel-Virginia	53.93%
Qwest-Washington	53.93%
Qwest-Idaho North	53.16%
Qwest-Utah	53.04%
Verizon NO-Contel/Quaker State	51.98%
Verizon NO-Contel/Illinois	50.20%
Verizon NW-Contel Washington	47.90%
Qwest-Minnesota	47.42%
Contel Nevada	47.17%
Qwest-Arizona	46.27%
Qwest-Oregon	45.92%
Southwestern - Missouri	43.31%
Michigan Bell	42.57%
Ohio Bell	42.19%
Verizon West Virginia	41.12%
GTE California	41.01%
Illinois Bell	40.81%
Verizon NW-Washington	40.46%
Verizon Virginia	40.37%
Wisconsin Bell	38.97%
Indiana Bell	37.99%
Verizon NO-Illinois	36.86%
AT&T/Southern New England Telephone	34.65%
Verizon NE - Maine	34.15%

Verizon SO-Contel-North Carolina	34.14%
BellSouth-Kentucky	34.01%
Verizon New Jersey	33.37%
Verizon-Maryland	32.84%
Verizon SO-North Carolina	32.76%
Qwest-South Dakota	32.62%
Verizon Florida LLC	31.67%
Verizon Pennsylvania	31.33%
Verizon Delaware LLC	31.15%
Verizon Washington D.C.	30.92%
Nevada Bell	30.83%
Verizon NW-Oregon	29.86%
Verizon NO-Ohio	29.72%
Verizon NO-Pennsylvania	29.29%
BellSouth-Alabama	27.28%
Verizon NO-Contel/Pennsylvania	26.96%
Verizon NO-Indiana	26.83%
BellSouth-Mississippi	26.43%
BellSouth-South Carolina	25.92%
Southwestern - Texas	25.11%
Verizon NO-Michigan	24.70%
BellSouth-Florida	24.55%
BellSouth-Tennessee	24.06%
Verizon NE - Vermont	23.55%
BellSouth-Louisiana	22.16%
Verizon NO-Wisconsin	21.96%
Verizon SW-Texas	21.03%
Verizon SO-Contel-South Carolina	19.96%
BellSouth-North Carolina	19.95%
BellSouth-Georgia	19.20%
Verizon SO-South Carolina	19.13%
Verizon SW-Contel-Texas	18.92%
Verizon SO-Illinois	14.22%
Verizon NE - Rhode Island	13.79%
Verizon NE - New Hampshire	12.83%
Verizon NE - Massachusetts	11.19%
Verizon New York Telephone	-1.33%
Verizon NW-West Coast California	-5.55%